Letter Ruling 99-1: Electronic Retailers

January 6, 1999

You request a letter ruling on behalf of ********** ("Corporation") to the effect that Corporation is not responsible for collecting the Massachusetts use tax imposed by G.L. c. 64I, § 2 in connection with its sales of goods to Massachusetts customers.

Facts

Corporation conducts a nationwide mail order business. Its product lines include: jewelry, sports cards, sports memorabilia, electronics, personal care products, small household appliances, rare coins, dolls, figurines, and other collectibles. None of Corporation's employees work in Massachusetts, nor does Corporation own any tangible personal property in the Commonwealth.

In conducting its business, Corporation advertises the products it offers for sale via televised live broadcast programs produced by Corporation from its studios in Knoxville. These programs are devoted exclusively to advertising the merchandise sold by Corporation. Corporation's broadcasts reach all fifty states plus portions of Canada and Mexico.

Corporation advertises its products in the Commonwealth via a subsidiary corporation, ********** ("Subsidiary"), which operates W__-TV, a cable television station located in Massachusetts that is licensed by the FCC to broadcast in the greater Boston area. Corporation acquired 100% of the common stock of Subsidary in February of 1995. The acquisition allowed Corporation to advertise in the Commonwealth on a more regular basis than it would have been able to otherwise. Prior to acquiring Subsidiary, Corporation purchased programming time on W__-TV. Currently, under Corporation ownership, Corporation's advertisements comprise the majority (approximately 83%) of W__-TV 's broadcasting activity; Corporation advertises on W__-TV approximately 120 to 140 hours per week. The remainder of W__-TV's broadcasting time is used to air the commercials of other clients, children's and public affairs' programming, and programs of television evangelists.

In selling its broadcasting time, W__-TV uses purchase order forms in lieu of formal contracts. Business is generally conducted on an informal week-by-week basis, and advertisements are customarily paid for before they are aired. Customers who view Corporation's advertisements on W__-TV can place orders by calling a Knoxville toll-free telephone number. Customers are required to pay for their purchases by credit card or personal check. Credit card purchases require prior approval by the credit card company before merchandise is shipped by Corporation. Also, Corporation does not fill any order that is paid by check until the check has cleared. Thus, Corporation does not engage in any collection activities in Massachusetts. All orders are approved in Knoxville. All of Corporation's inventory is warehoused at Corporation's headquarters in Knoxville. Merchandise sold by Corporation to Massachusetts buyers is either drop-shipped or delivered

through the mail or by common carrier.

Discussion

A. The Use Tax Statute – Generally

Under the Massachusetts General Laws a 5% use tax is imposed upon the storage, use, or other consumption in Massachusetts of tangible personal property purchased from any vendor for storage, use, or other consumption in Massachusetts. G.L. c. 64I, § 2. Liability for payment of the use tax is imposed upon the person who stores, uses, or consumes the property. G.L. c. 64I, § 3. However, if the purchase is made from a vendor engaged in business in the Commonwealth, the vendor must collect the use tax from the purchaser and remit it to the Commonwealth in a timely manner. G.L. c. 64I, § 4. No person may engage in business in Massachusetts as a vendor unless he/she first registers with the Commissioner of Revenue ("Commissioner") to collect sales and use taxes. G.L. c. 64H, § 7; G.L. c. 64I, § 9.

"Engaged in business in the commonwealth" is defined in pertinent part as:

> having a business location in the commonwealth; regularly or systematically soliciting orders for the sale of services to be performed within the commonwealth or for the sale of tangible personal property for delivery to destinations in the commonwealth; otherwise exploiting the retail sales market in the commonwealth through any means whatsoever, including, but not limited to, salesmen, solicitors or representatives in the commonwealth, catalogs or other solicitation materials sent through the mails or otherwise, billboards, advertising or solicitations in newspapers, magazines, radio or television broadcasts, computer networks or in any other communications medium; or regularly engaged in the delivery of property or the performance of services in the commonwealth.

G.L. c. 64H, § 1; G.L. c. 64I, § 1. *See also* TIR 96-8. Because Corporation regularly and systematically solicits orders for the sale of tangible personal property for delivery to destinations in the Commonwealth and exploits the retail sales market in the Commonwealth through television advertising and solicitation, it is clear that Corporation is "engaged in business in the commonwealth" within the meaning of the statute. This does not settle the issue, however.

B. Constraints

The above definition sets forth the nexus or jurisdictional standard for requiring out-of-state vendors to collect the Massachusetts use tax. Nexus is deemed to exist whenever an out-of-state mail-order vendor continuously and systematically solicits sales within the Commonwealth by mail, advertising, catalogues, or other means. However, this standard is enforceable only to the extent allowed under the Constitution or laws of the United States. *See* TIR 96-8.

1. Constitutional Limitations

The constitutional limitations are twofold. First, under the Due Process Clause of the United States Constitution some minimal connection with a taxing state is required before a tax can be imposed. U.S. Const. amend. XIV, § 1. "[D]ue process requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Brothers Co. v. Maryland,* 347 U.S. 340, 344-45 (1954). Second, under the Commerce Clause the states are prohibited from interfering unreasonably with the free flow of commerce between the states, by exercise of the taxing power or otherwise. U.S. Const. art I, § 8, cl 3. To survive a Commerce Clause challenge, a tax must (1) be applied to an activity with a substantial nexus with the taxing state, (2) be fairly apportioned, (3) not discriminate against interstate commerce, and (4) be fairly related to the services provided by the taxing state. *Complete Auto Transit, Inc. v. Brady* 430 U.S. 274, 279 (1977). *See also Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992); *Standard*

Pressed Steel, Co. v. Washington Department of Revenue, 419 U.S. 560 (1975).

2. Judicial Construction

There are four Supreme Court cases concerning constitutional limitations on a state's authority to require use tax collection which are of particular relevance here.

Scripto, Inc. v. Carson, 362 U.S. 207 (1960), represents the furthest extension to which the Court has permitted imposition of use tax collection responsibilities on an out-of-state vendor under the Constitution. *Quill* at 307. In *Scripto*, the Court upheld a Florida use tax as it applied to a Georgia corporation despite the fact that all of the corporation's in-state solicitation was performed by ten in-state independent contractors ("wholesalers" or "jobbers"). These individuals were contractually obligated to solicit orders for Scripto's products. Although Scripto had no office, property, or employees in Florida, the Court concluded that it had sufficient jurisdictional contact to be required to register as a vendor and collect and remit Florida use tax on its sales to Florida residents. Because the independent contractors were actively engaged in Florida as representatives of Scripto and were conducting continuous local solicitation in Florida for the purpose of attracting and obtaining Florida customers, the Court found the requisite nexus. Although the representatives were not employees of Scripto, "devoting full time to its service," the Court concluded that was "without constitutional significance." *Scripto* at 211. "The formal shift in the contractual tagging of the salesman as 'independent' neither results in changing his local function of solicitation nor bears upon its effectiveness in securing a substantial flow of goods into Florida. . . . "*Id*. Rather, what was critical to the finding of nexus was the "nature and extent of the activities" of the sales representatives. *Id*.

Tyler Pipe Indust. Inc. v. Washington Dept. of Revenue, 483 U.S. 232 (1987), like *Scripto*, stands for the proposition that under certain circumstances third-party activities related to an out-of-state vendor's business may be attributed to the out-of-state vendor and thereby serve to establish jurisdiction over the vendor. In *Tyler Pipe* the Court found the activities of one independent contractor residing in the taxing state sufficient to establish a taxable presence in the state on behalf of the out-of-state vendor to impose the tax in question. *Tyler Pipe* at 250-1. Tyler sold pipes, fittings, and drainage products to Washington residents. All of these products were manufactured in other states. Tyler maintained no office, owned no property, and had no employees residing in Washington State. Tyler solicited business in Washington through executives who maintained their offices out-of-state and through an independent contractor located in Seattle. The Court stated that "the crucial factor governing nexus is whether the activities performed in [the] state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in [the] state for the sales." *Id*. The Court found that this standard was satisfied because Tyler's sales representatives performed every local activity necessary for maintenance of Tyler Pipe's market and protection of its interests. *Id*.

Two decades before *Tyler Pipe*, the Court decided *National Bellas Hess, Inc. v. Department of Revenue,* 386 U.S. 753 (1967), suggesting that physical presence in a state is necessary to satisfy both Due Process and Commerce Clauses. *Bellas Hess* involved an attempt by Illinois to impose a use tax collection liability on a Missouri mail-order vendor that regularly sent catalogs and flyers to Illinois customers by mail and delivered goods to such customers by common carrier or mail, but which had no other contacts with the taxing state. Bellas Hess maintained no sales office in Illinois, nor did it employ any sales force in the state. The Court, invoking both Due Process and Commerce Clause theories, held that states may not impose a use tax collection obligation upon a vendor whose only connection with customers in the state is by common carrier or mail. In striking the tax down as it applied to Bellas Hess, the Court emphasized the burden "upon the free conduct of interstate business" that would result from use tax collection and how the "very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements." *Bellas Hess* at 759-60. Furthermore, due process requires that a state not impose such a burden on a party who does not receive some benefits from the state to justify that burden. The state must give something for which it can ask in return. Id. at 756.

The suggestion that physical presence in a state is necessary in order to satisfy the constitutional nexus requirement under the Commerce Clause was confirmed years later in *Quill.* The issue in *Quill* was whether North Dakota could apply its use tax to a business that had only minimal physical contacts with the state. Quill was a Delaware corporation with no employees in North Dakota. Also,

its ownership of tangible personal property in the state was either insignificant or nonexistent. Quill solicited business in the state through catalogs and flyers, general advertising, and telephone calls. It was the sixth largest vendor of office supplies in the state; Quill made almost $1 million in annual sales to 3,000 customers in North Dakota. It delivered all of its merchandise to its North Dakota customers by mail or common carrier from out-of-state locations. In rendering a judgment for Quill, the Court held that due process does not require physical presence in a state for the imposition of a duty to collect use tax, and overruled its prior holdings to the contrary, including *Bellas Hess* to the extent it rested on the Due Process Clause. *Quill* at 308. Turning to the Commerce Clause, however, the Court held that a vendor must have some contacts with the taxing state other than by common carrier or mail before it has substantial nexus required under the Commerce Clause and hence before a use tax collection responsibility may be imposed. *Id* at 311. Additionally, the Court "affirmed the continuing vitality of *Bellas Hess'* 'sharp distinction . . . between mail-order sellers with [a physical presence in the taxing] State and those . . . who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business." *Id*.

C. Corporation's Position

Corporation asserts that it does not have a use tax collection responsibility in Massachusetts because it does not have a physical presence in the Commonwealth. Corporation states that while the statutory definition of "engaged in business in the commonwealth" quoted above suggests that Corporation does have a use tax collection responsibility in Massachusetts since the Company contracts with an in-state cable television broadcaster and regularly delivers goods into the Commonwealth by mail or common carrier, the statute violates the Commerce Clause of the U.S. Constitution as interpreted in *Quill.* Corporation states that "General Laws c. 64H, § 1 is in plain contravention of the Commerce Clause as interpreted in *Quill* in that it seeks to impose a use tax collection responsibility on vendors that lack the requisite physical presence in Massachusetts." In particular, it seeks to impose a use tax collection responsibility on vendors such as Corporation whose only contacts with Massachusetts are limited to advertising and delivery by common carrier or mail.

Alternatively, Corporation states that Massachusetts should opt against asserting nexus with Corporation on the grounds that Corporation owns 100% of the common stock of Subsidiary which, as stated in the Facts above, operates W__-TV, a television station located in Massachusetts. "State attempts to attribute nexus by affiliation have generally been unsuccessful," Corporation states. *See SFA Folio Collections v. Commissioner*, 217 Conn. 220 (1991) and *Bloomingdale's by Mail v. Commonwealth of Pennsylvania*, 567 A. 2d 773 (1989).

D. *Quill* Distinguished

We do not agree that Corporation has no physical presence in Massachusetts. Nor do we agree that Massachusetts is precluded under *Quill* from imposing a use tax collection obligation on Corporation. The facts herein at issue are easily distinguished from those at issue in *Quill.* Quill, as stated in more detail above, had only minimal physical contacts with North Dakota; its only connection with customers in North Dakota was by mail or common carrier. Quill had no employees or independent sales representatives in North Dakota. In contrast, the presence of W__-TV in the Commonwealth and the fact that W__-TV is contractually obligated to perform ongoing activities on behalf of Corporation that are significantly associated with Corporation's ability to establish and maintain a market in Massachusetts are sufficient to establish Corporation's physical presence in Massachusetts. *See Scripto* and *Tyler Pipe*.

E. Nexus by Affiliation

Corporation asserts that state attempts to attribute nexus by affiliation have generally been unsuccessful, citing *SFA Folio Collections* and *Bloomingdale's by Mail.* However, in these cases, the local affiliate did not advertise on behalf of, solicit sales for, or otherwise act as a representative of the out-of-state vendor. In contrast, nexus has been found where an agency relationship between the affiliates exists. *See Reader's Digest Association, Inc. v. Mahin*, 44 Ill. 2d 354, 255 N.E. 2d 458 (1970), *cert denied* 399 U.S. 919 (1970). Our conclusion is not based primarily upon the common ownership of Corporation and W__-TV. Rather, the presence of W__-TV in the Commonwealth and

the fact that W__-TV performs activities on behalf of Corporation that are significantly associated with Corporation's ability to establish and maintain a market in Massachusetts form the basis for our ruling. Together they suffice to establish Corporation's physical presence in and nexus with Massachusetts. *See Scripto* and *Tyler Pipe*.

F. In-State Activities of In-State Representative Provide Requisite Contact

It is well settled that under certain circumstances third-party activities related to an out-of-state vendor's business may be attributed to the out-of-state vendor and thereby serve to establish jurisdiction over the vendor. As stated above, *Tyler Pipe* held that an out-of-state vendor was subject to tax even though its sole connection with the taxing state was through the actions of independent contractors, because the contractors were involved in activities that were significantly associated with the vendor's ability to establish and maintain a market in the state. Also, as stated above, *Scripto* similarly determined that a taxing state had nexus with an out-of-state vendor solely on the basis of the presence of independent contractors in the taxing state. The *Scripto* Court found the requisite nexus because the independent contractors were actively engaged in the taxing state as representatives of the vendor for the purpose of attracting, soliciting, and obtaining customers in the state.

In establishing nexus, the function served by the in-state representative is, as indicated above, a crucial factor. Is the representative involved in establishing and maintaining a market for the out-of-state vendor in the taxing state? Is the representative doing the out-of-state vendor's business for it, or is it simply engaging in its own business and incidentally helping the out-of-state vendor establish and maintain a market in the taxing state? It is the performance of the in-state activities by an in-state representative on the out-of-state vendor's behalf that extends those nexus creating activities and the in-state presence to the vendor.

1. W__-TV is Corporation's In-State Representative

Corporation maintains that W__-TV is not engaged in business in the Commonwealth on Corporation's behalf, but is in the business of selling broadcasting time. Corporation also maintains that it is merely one of W__-TV's many clients. The suggestion is that performing functions for many companies is akin to conducting one's own business. However, the facts do not support such claims. Were W__-TV engaged in the business of selling broadcasting time, as Corporation maintains, it would as part of its business operations air the commercial advertisements and programs of many clients. But, it does not. As stated in the Facts above, Corporation owns 100% of the common stock of the corporation that operates W__-TV, a relationship that enables Corporation to broadcast sales solicitations in the Commonwealth on an almost continuous basis. Corporation's infomercial advertisements dominate W__-TV's broadcasting activity, comprising approximately 83% of the station's total air time, leaving W__-TV with few other clients. W__-TV airs Corporation's infomercials 120-140 hours per week. Under these circumstances, we conclude that W__-TV is engaged in business in the Commonwealth on Corporation's behalf as its in-state representative and that its presence in the Commonwealth is properly imputed to Corporation for purposes of determining the Commonwealth's use tax jurisdiction.

2. W__-TV's Activities Enable Corporation to Establish and Maintain a Market in the Commonwealth

By broadcasting on W__-TV, Corporation is able to attract and obtain Massachusetts customers on practically a full-time basis. W__-TV broadcasts Corporation's infomercials in Massachusetts almost continuously. Corporation does not solicit business in Massachusetts through any other means. Thus, it is the broadcasting activity, conducted by W__-TV on Corporation's behalf, which enables Corporation to establish and maintain a market in Massachusetts and establishes the Commonwealth's use tax jurisdiction. *See Scripto* and *Tyler Pipe*.

Conclusion

While we agree that a non-Massachusetts vendor generally will not create nexus with the Commonwealth under the standard set out in *Quill* by advertising in a local newspaper or on a local television station, we conclude that the unusual facts of this case compel a different outcome. We

rule that Corporation has nexus with Massachusetts and, thus, a Massachusetts use tax collection responsibility in connection with its sales of goods to Massachusetts customers. Two facts form the basis for our ruling: (1) the physical presence of W__-TV in the Commonwealth and (2) the fact that W__-TV performs extensive activities on behalf of Corporation (over 80 percent of its total broadcast hours) that are significantly associated with Corporation's ability to establish and maintain a market in Massachusetts. Together, they create Commerce Clause nexus for Corporation. *See Scripto* and *Tyler Pipe.*

Very truly yours,

/s/Bernard F. Crowley, Jr.

Bernard F. Crowley, Jr.
Acting Commissioner of Revenue

MA:HMP:pls

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